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FACING NEW RISKS

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JUNE 1990 VOLUME 50 NUMBER 9

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Servicing

What's easier—scaling the side of a vertical rock face or servicing a GNMA portfolio with loans in Colorado and Louisiana? The June issue does not attempt to answer that question but it does suggest there are some new high-risk factors on the servicing landscape. Additional obstacles now hanging over the heads of servicers include pending federal legislation that could lead to stiff money penalties for abusing consumers in servicing transfers. Other risks that stand out include the federal regulators' restrictive capital treatment of purchased servicing, servicing's delicate price situation with the RTC ready to liquidate a sizeable servicing stockpile and the apparent desire of the IRS to investigate the taxability of retained servicing.

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COVER PHOTOGRAPH BY DAVID LISSY / FPG

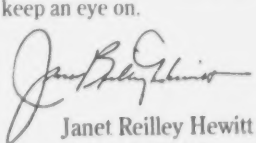
SERVICING
A Real Cliff-Hanger

Just when you think you've got a real grasp on what it takes to make decent returns on a servicing operation, somebody does something that makes the ground fall out from under you. Perhaps the rock climber on our cover this month overstates the risks currently facing servicers trying to straddle the thin line between the red ink and the black. But increasingly, I suspect, servicers feel like they're being caught between a rock and a hard place.

Washington is the source of much of this anxiety. The FDIC's proposed regulation that puts a 25 percent limitation on the amount of purchased servicing that can count toward core capital is already creating a chill in the marketplace. Regulated institutions who buy servicing feel the proposed rule has once again shifted the playing field in a way that puts them at a marked disadvantage. Even the Resolution Trust Corporation is balking at the proposal because it makes it harder to find buyers for the RTC's growing inventory of servicing. The RTC's inventory is having its own impact on the servicing market—the overhang of government-held servicing is depressing prices.

Housing legislation moving through the U.S. House of Representatives is carrying provisions that affect mortgage servicers. The House version of major housing legislation contains provisions authored by Rep. John J. LaFalce (D-NY) that would create new money penalties that servicers could be hit with if a court finds they have shown a "pattern or practice of noncompliance" with the servicing transfer rules outlined in the bill. At the time this was written, those provisions also created the opportunity for aggrieved borrowers to press class action suits against servicers. The bill lays out rules for upfront disclosure to borrowers about the likelihood that the servicing will be sold. It also requires originators to detail for the borrower what past practice has been and whether there is present intent on the lender's part to sell that person's servicing. Then on top of that, the bill details what will be required as far as notice to consumers when an actual servicing transfer takes place.

The Internal Revenue Service is yet another Washington-based institution that has taken a new interest in the servicing business. A case in Michigan involving an IRS agent has raised some eyebrows. Reportedly, the lone agent, acting on his own, launched the theory that originated servicing should be taxed from the moment it is put on the servicer's books. A copycat case has reportedly sprung up in Texas, so the IRS is yet another federal entity that servicers should keep an eye on.



Janet Reilley Hewitt
Editor in Chief

Editor's Note: The May Economic Trends column was mistakenly edited to imply that it was the columnist's (Thomas M. Holloway) opinion that home prices peaked in 1988. This is not his view.

COMING IN JULY

An issue devoted to key trends in commercial real estate finance is in the works for next month.

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Servicing

The New Environment

A little self-knowledge can go a long way towards preparing lenders for servicing's most recent trends.

Two major trends are now quite clearly established in the mortgage servicing industry. One is the rising incidence of turnover in servicing assets. The other is consolidation of the number of players in the mortgage servicing business.

The capital regulations for thrifts mandated by the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) will lead to further substantial changes in the supply and demand dynamics of the servicing market. These changes will promote further consolidation and foster a new trend toward tiering in the servicing market.

FIRREA permits both the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) a role in the regulation of servicing assets on thrifts' balance sheets. The OTS capital regulations became effective in December 1989. They are generally directed toward the maximum permissible valuation of purchased servicing on the balance sheet and the degree to which the purchased servicing may be included in capital. While to date, the FDIC has only proposed servicing regulations in response to FIRREA, we anticipate that when finally adopted, they will generally direct themselves to the maximum percentages of capital that purchased servicing may represent on the balance sheet.

The OTS' capital regulations specify three distinct capital standards for thrifts: risk-based capital, core capital, and tangible capital. The capital requirement for servicing depends not only on each different capital standard but also on the form that the servicing takes.

Broadly speaking, servicing rights can appear in three different forms: retained servicing, purchased servicing, and capitalized excess servicing. Because retained servicing is seen as the residual processing activity that results from the servicer's own loan production, it does not appear as an asset on the servicer's balance sheet. Therefore, retained servicing is appropriately not addressed in the thrift capital regulations.

Capitalized excess servicing is the asset that results from the capitalization or present valuing of a portion of retained servicing fees that are above the GAAP defined normal servicing fee. Purchased servicing is operationally equivalent to retained servicing except that the servicer purchases the servicing as an on-balance-sheet asset instead of originating it. The treatment of the purchased and capitalized excess servicing assets varies importantly among the capital categories, as we will discuss.

OTS risk-based capital

Risk-based capital regulations generally establish four grades or classes of assets and set a different fraction of the required capital for each class of asset. The base capital requirement is 8 percent of assets, and those assets that are of superior creditworthiness are placed in a risk class that permits a lower specified fraction of the 8 percent capital. In the initial issuance of the capital regulations, both purchased and capitalized excess servicing were placed in the 100 percent risk class, thus requiring 8 percent capital. The OTS acknowledged that it placed servicing in the 100 percent risk class while many of the mortgages on which the servicing is performed are in a lower risk-weighted class. Since the current capital regulations treat only credit risk, the OTS decided to place servicing (and other assets with concentrated interest rate or prepayment risk, namely IOs, POs, residuals, and certain CMO tranches) in the 100 percent category until it issues the interest rate risk component of its capital regulation, presumably in the first half of this year. When the credit and interest rate risks are given separate capital standards, we anticipate that the credit risk class for purchased and capitalized excess servicing will be lowered toward that of the underlying mortgages.

OTS core capital

The regulations set 3 percent of assets as a minimum for core capital. The definition of core capital generally requires the deduction of intangible assets. Capitalized excess servicing is specifically defined as a tangible asset. While purchased servicing and supervisory goodwill are generally defined

Hal Hinkle, Steve Harris and Dick Loggins

FIGURE ONE

Amortized Book Value of Purchased Servicing

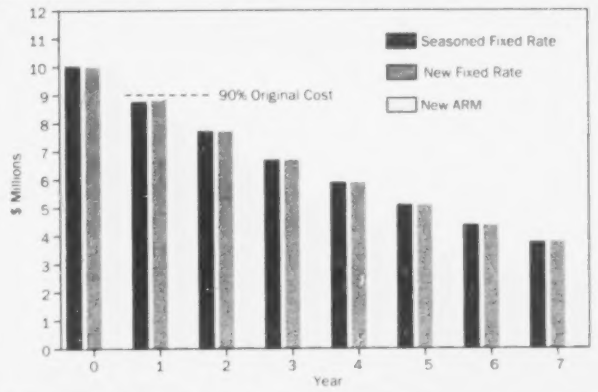


FIGURE THREE

Amortized Book Value Verses 90% Fair Market Value (200 bp decline)

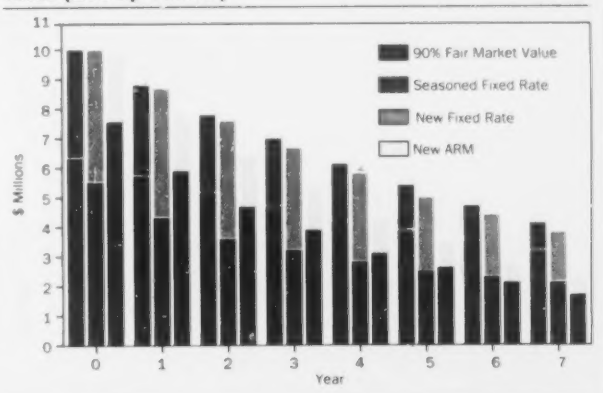


FIGURE TWO

Amortized Book Value Versus Amortized Book Value Plus Earnings

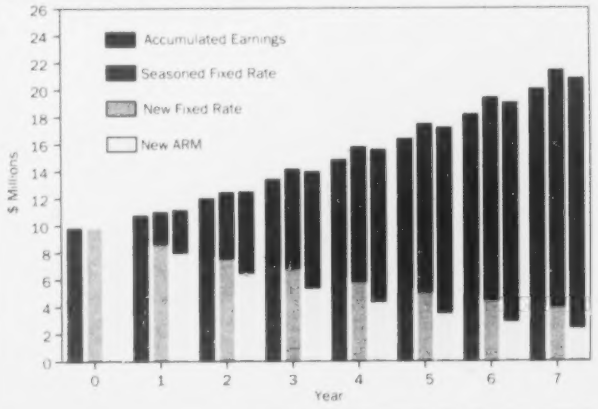
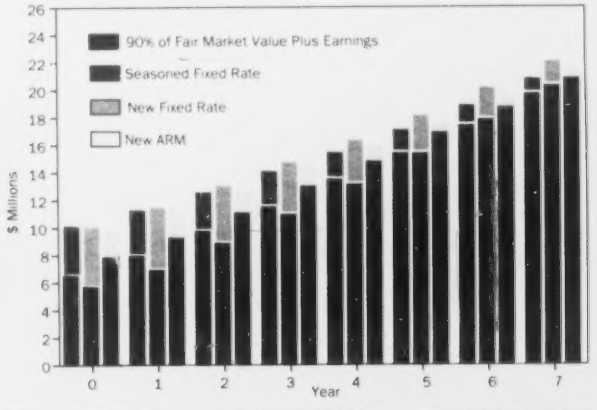


FIGURE FOUR

Amortized Book Value Plus Earnings Versus 90% of Fair Market Value (200 bp decline) Plus Earnings



as intangibles in the regulations, for the purpose of calculating core capital, they are counted or "included" as assets—but only up to a certain specific valuation limit. In the case of purchased servicing, the maximum portion or valuation that may be included in assets for the core capital calculation is the lesser of: 90 percent of the original cost, the current amortized book value as determined under GAAP, or 90 percent of the fair market value to the extent determinable.

The OTS capital regulations do not currently state the manner or frequency with which the servicing rights should be marked to market. However, the authorizing FIRREA language does state that the "fair market value of purchased mortgage servicing rights shall be determined not less often than quarterly."

OTS tangible capital

The regulations set the minimum tangible capital at 1.5 percent of assets. Similar to core capital, the definition of tangible capital requires the deduction of intangible assets. For tangible capital purposes, the one intangible that is still included in assets is purchased servicing. The "includability" of purchased servicing for tangible capital is still subject to the same maximum includable valuation conditions stated above.

The distinction between core and tangible capital is designed to be phased out. By January 1995, the stepped elimination of supervisory goodwill will leave both core and tangible capital effectively at the same general leverage limit of 3 percent.

FDIC maximum limitations

In addition to the above OTS capital regulations regarding the maximum valuation of purchased servicing that may be counted toward capital, FIRREA also potentially limits the percentage of a thrift's capital that can consist of purchased servicing. This regulation is issued by the FDIC. That the FDIC should play a regulatory role for a particular asset type is both curious in origin and possibly the most constraining in practice.

The general approach taken in FIRREA was to set thrift capital standards at levels no less stringent than those applied to national banks. The asset powers of national banks are regulated by the Office of the Comptroller of the Currency (OCC). Prior to the thrift crisis, the FDIC, the OCC, and the Federal Reserve had already adopted their risk-based capital adequacy regulations. On the matter of purchased servicing, only the OCC had specified the maximum percentage (not valuation) that can be included in assets when calculating capital. Specifically, the OCC set a limitation of 25 percent of Tier One (which is equivalent to core) capital that can be invested in

TABLE ONE

Thrift Participants in the Servicing Markets (as of 6/30/89)
($ millions)

	Insolvent Thrifts	Deficient Thrifts	Borderline Thrifts	Healthy Thrifts
Tangible Capital as a % of Assets	<0%	0%-1.5%	1.5%-3.0%	>3%
Number of Thrifts	521	150	277	2,206
Total Assets	$297,245	$151,038	$301,399	$656,667
Purchased Servicing	$426	$545	$616	$428
Excess Servicing	$349	$514	$757	$753
Loans Serviced for Others	$58,191	$69,056	$99,193	$152,482
Sources of Supply				
Estimated Retained Servicing	NR	$37,900	$64,000	$128,000
Estimated Latent Capital as a % of Assets	NR	0.25%	0.21%	0.20%
Sources of Demand				
25% of "Adjusted Capital" Core (1995)	NR	NR	$1,650	$9,671
Capital Capacity for Purchased Servicing	NR	NR	$1,276	$7,736

purchased servicing.

In its initial risk-based capital standards, the FDIC did not indicate a specific percentage limitation for purchased servicing. During the drafting of FIRREA, industry and constituent pressure prevailed on congressional staff so that the final language directed the percentage limitation to be "the amount that could be included if the savings association were an [FDIC-regulated] insured State nonmember bank," thus potentially obviating the OCC's 25 percent limitation.

Since FIRREA, the FDIC surprised and disappointed many by indicating that it would readdress its standing regulations on purchased servicing. On January 26, the proposed regulations were released and set a 25 percent of core capital and 50 percent of additional tangible capital limit. As proposed, there is a grandfather exemption of those servicing rights on institutions' balance sheets as of August 9, 1989. The exemption is proposed to phase out by December 31, 1994. Given the conservative nature of the OTS's maximum includable valuation requirements, there is some validity to the argument that FDIC should adopt a more liberal limitation than the OCC's.

Since servicing is naturally more prevalent in the thrift industry than it is in the commercial banking industry, even with this grandfather provision many individual thrifts could be severely affected by FDIC percentage limitation regulations. Specifically, there are over 20 thrift servicers with purchased servicing in excess of $1 billion dollars that would be affected without grandfathering.

Applying the capital standards

For years, thrifts, and to some extent banks, have compared investments on a return-on-assets (ROA) basis. The recent adoption of the comprehensive capital regulations for both thrifts and banks, however, will probably encourage a greater use of a return-on-capital or return-on-equity (ROE) measure for asset selection. In this regard, the OTS for thrift institutions has placed a severe capital handicap on purchased servicing. Further, because of the presence of three alternative treatments, just applying the OTS' standards will prove to be complex, and the effects may be surprising.

In a world of limited (and costly) capital, institutions must zealously guard the claims on their capital.

Under the OTS standards, both the availability of capital to support purchased servicing and the return on equity will affect a thrift's willingness to hold this capital intensive asset on its balance sheet. Even assuming effective capital requirements near 18 percent (10 percent haircut + 8 percent risk based requirement), the current levels of pre-tax returns on servicing can generate ROEs in the neighborhood of 40 percent. Although this is attractive when compared with traditional thrift business lines, sufficient capital must be available to support purchased servicing.

In a world of limited (and costly) capital, institutions must zealously guard the claims on their capital. The potential claims of the OTS' core and tangible capital requirements are important to assess, and the interplay of the three maximum valuation criteria produces some surprising implications for the acquisition and holding strategies for purchased servicing.

To illustrate the interplay of the three maximum valuation criteria, it is necessary to start with the simplification of ignoring the fair market value criterion. Figure One illustrates the interplay between the 90 percent of original cost and the current book value criteria for three acquired servicing portfolios. Each portfolio has the same original investment ($10 million) and the same projected internal rate of return (15 percent). Portfolio A is similar to the average portfolio implied in the Mortgage Bankers Association's *Income and Cost of Origination and Servicing of 1 to 4 Family Residential Loans*, i.e. a modest loan balance, seasoned, fixed rate portfolio. Portfolio B is a recently originated fixed-rate portfolio and Portfolio C is a recently originated ARM portfolio. Before interpreting the figure, it is helpful to recall that GAAP amortization of deferred premiums of purchased servicing is usually in proportion to the undiscounted expected net servicing revenues.

Note that the book value of the ARM portfolio declines considerably faster than the book value of the other two portfolios. ARMs generally season quicker and prepay faster than comparable fixed rate mortgages. Hence the balance on the portfolio will decline more rapidly. To obtain the

same internal rate of return on the initial investment, an ARM portfolio (or any fast prepaying portfolio) will produce greater net revenues in its earlier years than a slow prepaying portfolio. The rapid decline of book value for an ARM or high coupon portfolio appears to make it unattractive from a capital standpoint. Given equivalent economics (and still ignoring the fair market valuation impact), the implication may be that a modestly capitalized thrift should prefer low coupon, long maturity or unseasoned servicing rights, since it will not impair capital as quickly.

When the earnings on purchased servicing assets are added back to capital, the risk of claims on capital changes substantially. Figure Two shows these same three portfolios with the earnings (pre-tax) added back to amortized book value. Specifically, note the surprising result for the ARM portfolio. Since the majority of its cash flows occur early, the ARM portfolio's contribution to capital will grow faster initially than the other portfolios. This is because its earnings stream is concentrated in its short period of positive net revenues. The perceived risk of high prepayments can apparently be more than offset by the effect of the front loading of capital contributions.

This example highlights a subtle characteristic in the nature of the returns to servicing that merits specific mention. While a servicing portfolio may be said to have a certain positive internal rate of return, that internal rate of return is composed of positive net revenues during the early years and negative net revenues in the later years, once costs have risen and loan balances fallen. As a result, the accounting returns in the early years can substantially exceed the stated internal rate of return. Further, the faster the base rate of prepayment, the stronger the front loading of income. Thus, portfolios with presumed faster prepayment speeds may provide a better capital risk-to-return profile for thrifts than is commonly presumed.

When the fair market value criterion enters the capital picture, further complexity is injected, which we illustrate with three examples. First, even if price levels in the servicing market are generally unchanged, to the extent that a specific portfolio's market value declines naturally over time from seasoning and maturation, 90 percent of original cost will become irrelevant, since the same 10 percent haircut is applied to fair market value.

Second, the fair market value requirements are quarterly, thus overwhelming the initial 90 percent original costs if general market values fall. Third, if interest rates drop, the sensitivity or elasticity of prepayments to interest rates becomes an important factor. An ARM portfolio's prepayments do not increase as rapidly as a fixed rate portfolio's prepayments in a declining interest rate environment. Further, an extremely seasoned portfolio is relatively inelastic to changes in interest rates. In Figure Three we show the same three portfolios along with estimates of 90% of market value for a decline of 200 basis points (bp) at the end of each (though not cumulative) of the first seven years. The estimates assume a parallel shift of 200 bp for both refinancing rates and discount rates.

As can be seen in the figure, the portfolio that embodies a greater risk of capital claim is not necessarily easy to assess at the outset. The inelasticity of prepayments to interest rates for a well-seasoned portfolio and for an ARM portfolio allow them to withstand interest rate fluctuations without sustaining a dramatic reduction in capital.

Capital preservation, not prepayments in an isolation, is the risk that must ultimately be managed. With purchased servicing, capital is increased with revenues and deteriorates with prepayments or declining market values. In Figure Four the resultant capital on the balance sheet is shown for the current rate environment if interest rates drop 200 bp. In the current environment, portfolio B appears to have the best relative effect on capital. However, if interest rates drop 200 bp, the ARM portfolio with its front-loaded cash flows and relatively inelastic prepayment function would sustain its capital value the best.

Understanding the optimal implementation of the OTS's standards will be tricky. When analyzing a servicing portfolio, a thrift must examine not only the ROE but also when the cash flow occurs and what happens to capital if interest rates change. A thorough analysis of multiple prepayment scenarios should give a level of comfort to cash flow timing. Meanwhile an examination and implementation of hedging methods can mitigate the interest rate concern. Here,we certainly are not attempting to make an argument for the value of ARM servicing; rather, our analysis of the net capital impact of holding purchased servicing has indicated a better-than-expected outcome for ARM portfolios.

Impact on thrift servicers

For all of the far-reaching impact that the FIRREA-mandated capital regulations will have on the thrift industry's balance sheet structure, surely servicing will be one of the assets most pervasively affected. As thrifts set out to restructure their balance sheets to secure capital or improve earnings, the disposition or acquisition of servicing assets will be primary targets in many cases. In Table One we have segregated the thrift industry into four categories based upon levels of core capital adequacy. For each category, we will discuss the anticipated actions and resulting impact on the servicing market.

Insolvent thrifts. The vast majority of the insolvent thrifts will soon be subsumed within the Resolution Trust Corporation (RTC). Of the nearly $65 billion in servicing rights in insolvent thrifts, over 80 percent of them are held in about a dozen mortgage banking subsidiaries. To some degree, all of this potential supply can be seen as coming from one seller: the RTC and its advisors. Together, they have been undertaking a judicious and market-sensitive disposition of these assets to minimize market impact. To date, less than $5 billion has been transferred. In some instances the RTC is attempting to consolidate smaller units of servicing into larger servicers to improve the interim quality of servicing and make the ultimate sale more acceptable to the market. Ultimately, when these sales are executed, the complete portfolio will be liquidated. The timing of this supply will largely be determined by the funding constraints of the RTC and the valuation views of its advisors.

Capital-deficient thrifts. Sales of retained servicing rights, i.e., uncapitalized servicing, will be an im-

portant source of capital for capital-deficient thrifts. We estimate roughly that there is more than $30 billion in retained servicing rights held by capital deficient thrifts. If all of these rights could be sold for an average price of 1 percent of the unpaid principal balance, then an average thrift could improve its core and tangible capital by approximately .21 percent of assets, on a pre-tax basis. For many thrifts, this will represent an important source of capital. While the implied cost of capital from many servicing sales will be high nominally, in a number of cases, sales of retained servicing will be one of the few options available to raise capital. Accordingly, the supply of servicing will be increased in the future by sales from these institutions, though not necessarily by the full $30 billion.

Sales of retained servicing by those thrifts that have capitalized excess servicing on the same loans will be somewhat tempered. Current accounting constraints regarding gain on sale for subservicing transfers will lessen sales where the book value of the capitalized excess servicing is greater than the excess servicing's pro rata portion of sales proceeds. Likewise, agency restrictions on stripping excess servicing, split remitting, and subservicing responsibilities will also lessen sales where the book value of the capitalized excess servicing is greater than the pro rata portion on the sales proceeds. To the extent that the proceeds from the sale of total servicing (retained and capitalized excess) are greater than the book value of the capitalized excess, these sales will still be a source of capital.

In the end, to the extent that capital-deficient thrifts survive independently of the RTC, we expect that the final effect of servicing sales from capital deficient thrifts will add much less than .21 percent of assets to capital and result in perhaps less than $20 billion in supply of mixed investor and product type of servicing rights over the next two years. As these thrifts are taken over by the RTC, if their resolution is achieved by liquidation and not whole thrift sales, then a much greater portion of servicing will enter the market.

Borderline thrifts. Much of the motivation to sell retained servicing rights facing the capital-deficient thrifts is also present for the borderline thrifts. The lower the core capital of a borderline thrift the more powerful is the motivation to sell. As with the capital deficient thrifts, the presence of a high relative book value for any capitalized excess portion will lessen the motivation to sell. Of the estimated $64 billion of retained servicing held by borderline thrifts, we estimate that between $30 and $40 billion represent potential supply in the servicing market over the next two years. Thrifts with core capital closer to that of healthy thrifts, on average, will be buyers more frequently than sellers.

Healthy thrifts. Except for strategic restructurings of individual institutions, which may generate a limited number of servicing sales, we believe that healthy thrifts represent a considerable source of potential demand in the servicing market. Throughout most of 1989, thrifts as acquirors of servicing have been relatively quiet while they waited for the new capital regulations. Now that the capital consequences of owning servicing are

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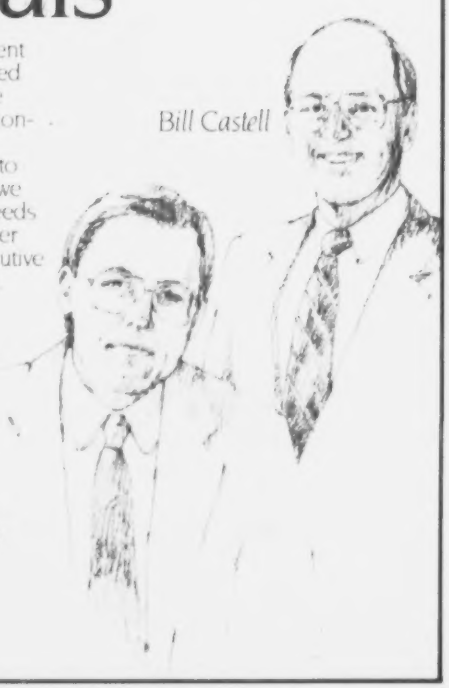

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MBA

being clarified, capital-healthy thrifts can now re-enter the servicing market as acquirors.

It is interesting to speculate about the amount of potential demand for servicing that may come from the re-entrance of healthy thrifts into the servicing market. From a capital capacity point of view, healthy thrifts, in aggregate, might represent potential demand equal to or greater than the potential supply from the more poorly capitalized thrifts. To illustrate, we calculated maximum capital capacity of healthy thrifts to buy servicing. Presuming that a 25 percent of core capital limitation applied, that an additional 20 percent valuation haircut was taken, and that risk-based capital was sufficient, the theoretical capacity of healthy thrifts to buy servicing would exceed $400 billion,or more than two times the maximum amount that the weaker part of the thrift industry could sell. By making these calculations, we are not suggesting that healthy thrifts will suddenly dominate the servicing market. Rather, we do believe that there is more potential demand within the thrift industry than has been generally thought in the marketplace.

Tiering in the market

The above discussion has presented some of the changes in the supply and demand dynamics of the servicing market that may be wrought as thrifts respond to the new capital regulations. Obviously, the trends toward increasing turnover and consolidation will continue. More notably, the trend toward tiering will become increasingly visible and important. We conclude this report with a discussion of the tiering and the opportunities that can arise for individual participants.

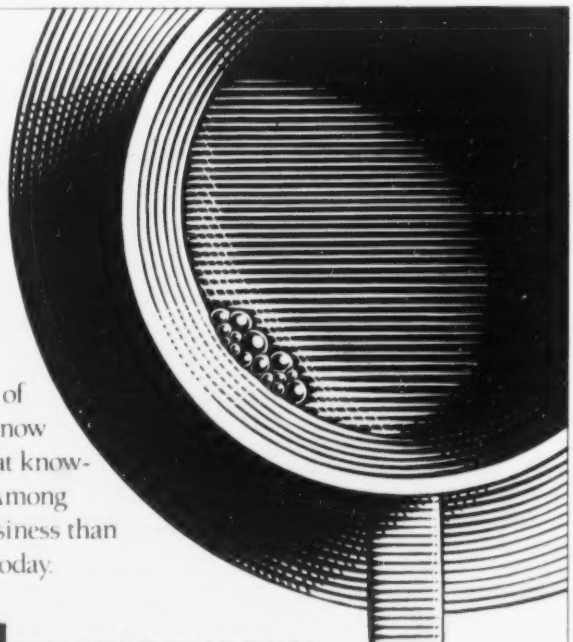
Over the last several years, the bulk of supply in the servicing market has been somewhat homogenous, consisting of GNMA, Fannie Mae, and Freddie Mac fixed-rate products. The majority of these products has been put into the market by mortgage bankers. Now that thrifts are starting to provide an increasing supply, the distribution of product types in the servicing market is shifting. Historically, thrifts have been more active than mortgage bankers in recourse, private investor, adjustable rate, and other, less-commodity-like, servicing.

Many observers have confused this shift in the distribution of product types available in the market with a condition of oversupply. While it is true that the average price in the servicing market has declined over the last 12 months, we find that it is as much driven by a shift toward more lower priced types of servicing as it is by a shift in supply and demand. In order to properly evaluate the supply and demand conditions in the servicing market, participants must now fully recognize the trend toward tiering in the servicing market. High quality, large average-balance, fixed-rate servicing continues to be aggressively bid, while seasoned, recourse, adjustable rate or private investor servicing is scantily bid and sometimes not even bid at all. Clearly the occurrence of tiering in the servicing market makes it perilous today to talk in terms of historical relative prices.

Opportunities

The opportunities arising in the servicing market ultimately come not

It Takes About Five Cups Of Coffee To Process A Mortgage Loan



That's the number of cups a loan officer might share with one of your customers, based on the average number of times they'll meet or talk on the phone over the course of a mortgage loan.

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from the generally high level of nominal returns for servicing, but rather from the crude and inefficient pricing mechanism of the market, which frequently results in mispriced portfolios.

Two practices contribute to this mispricing. First, many servicers still have only a moderate understanding of their own operational and financial economics as well as their own relative strengths. Second, when evaluating and bidding targeted portfolios, servicers frequently adjust or bias their input assumptions toward their belief of market averages and levels instead of employing inputs directly reflecting their own operational and financial economics.

As tiering becomes accepted, buyers will have to take stock of their own comparative advantage relative to the plethora of product types being offered. Few servicers today can be said to be equally proficient at servicing every type of mortgage product. Each servicer should bid more aggressively for those products that fit its relative operational or financial strengths. Servicing has high nominal returns precisely because the returns are so uncertain. The more a portfolio fits the servicer's relative capabilities, the more likely it is that the servicer will earn a projected return.

To illustrate some of the opportunities that can arise when portfolios are priced to perceived average characteristics and assumptions:

- Servicers with strong collections and foreclosure departments can develop a niche in more delinquent portfolios.
- Servicers with strong capital bases can pursue recourse portfolios.
- Servicers with strong investor relations departments can focus on private investor portfolios.
- Servicers with a strong systems and customer service staffs can specialize in adjustable rate portfolios.
- Servicers with strong underwriting and due diligence staffs will be comparatively advantaged to pursue RTC portfolios, since only limited representations and warranties are usually provided.
- Servicers with a strong servicing cost per loan advantages can achieve superior returns on low loan balance portfolios as long as the market prices them to a higher average servicing cost.
- Servicers with affiliated balance sheets that possess considerable positive duration will benefit relatively from higher coupon portfolios.
- Servicers with sophisticated finance and interest rate risk management capabilities can pursue high servicing fees portfolio where the return profile can be significantly stabilized by use of derivative mortgage products.

In practice, of course, most portfolios are enough of a mixture of characteristics and product types so that the bidding manager must assess the predominance of those product types within a portfolio that fit the relative strengths of the bidding company. In the end, the most powerful evaluation tool that will contribute to the success of a servicer's acquisition (or restructuring) strategy is a little self knowledge. **MB**

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